Minutes Of The Meeting Of The
Treasury Borrowing Advisory Committee
Of The Securities Industry and Financial Markets Association
May 1, 2007

The Committee convened in closed session at the Hay-Adams Hotel at 11:35 a.m. All Committee members except Richard A. Axilrod were present. Under Secretary Robert Steel, Assistant Secretary Anthony Ryan, Deputy Assistant Secretary Matthew Abbott and Office of Debt Management Director Karthik Ramanathan welcomed the Committee and gave them the charge.

The Committee addressed the first question in the Committee charge (attached) regarding debt issuance in light of intermediate and longer-term fiscal trends as well as recent economic and market conditions. Director Ramanathan presented a series of charts discussing the continued strong growth in individual, corporate, and non-withheld receipts as well as the slower growth of outlays in fiscal year 2007. In addition, the charts showed the Administration's projections of a rapidly improving fiscal outlook with a balanced budget by 2012. Director Ramanathan noted that increased issuance of State and Local Government Series (SLGS) securities has led to a decline of nearly $50 billion in marketable borrowing needs.

In order to promote large, liquid sizes in its benchmark securities and in light of potential reduced borrowing needs in the near future, Director Ramanathan noted that one possible option would be to discontinue the 3-year note following the May 2007 auction. Director Ramanathan noted that current issuance sizes across bills and coupons may be approaching their lower limits. Discontinuing the 3-year note would promote liquidity in bills and other benchmark securities and eliminate the need for Treasury to resort to larger cuts across the curve which could impede market efficiency. Moreover, given the fiscal outlook and portfolio considerations, adjusting the auction calendar at this time was feasible. Director Ramanathan stated that Treasury had the capacity to raise more than $200 billion through increased bill and coupon issuance if needed through its current menu of offerings.

Another chart noted that TIPS and longer term securities – based on current issuance patterns and sizes – would be primary tools in raising funds in the future. If positive fiscal trends continue in the future, additional reductions may be necessary through coupon reductions or calendar adjustments across the portfolio. The TBAC in the February 2007 meeting had suggested the 5-year TIPS as well as a consolidation of the 10-year note as other possible options. These options and others may need to be explored if current positive trends persist.

Director Ramanathan then noted that the TBAC may want to consider several factors when contemplating adjustments to the auction calendar including portfolio considerations, the intermediate to long-term trends, non-marketable borrowing, and potential legislative changes. From a portfolio perspective, the ability to offer the market large, liquid offerings on its benchmark securities and grow the bill sector was important. The economic outlook remains stable but Treasury's current auction calendar has the ability to raise a large amount of funds fairly rapidly. Non-marketable borrowing trends, particularly those related to SLGS, could moderate, but a low interest rate environment may precipitate additional refinancings and issuance over the next few years. Finally, legislative changes related to tax policy or entitlement reform could occur and impose additional funding requirements, but the Treasury generally remained capable of funding such needs.

The Committee turned to the decision facing the Treasury regarding the discontinuance of the 3-year note. One member noted that there is no futures contract and that any 3-year assets that investors want could be obtained through the Eurodollar market and swaps. Given both the decline in fiscal needs and concern about maintaining large liquid benchmarks, the Committee member noted that discontinuing the 3-year note at this point was sensible. Another member noted that market participants hoping to invest in the three-year space could purchase off the run 5-year notes as they roll down the curve.

One member raised caveats including uncertainty about the Alternative Minimum Tax provisions, war expenditures, and cash outflows starting in 2008 and 2009. This member noted that if the fiscal situation becomes more pessimistic, the discontinuance of the 3-year note may put significant pressures on other instruments. This same member noted, however, that outlays remain below trend, and this might continue into the 2008 elections as Congress potentially remains in gridlock.

Some members expressed the view that there was significant capacity to increase issuance in benchmark issues and bills. Several members noted that the market would welcome larger sizes in the core benchmark securities should the situation warrant such action. Other members noted that if at some future date, it was determined that more intermediate financing was needed, Treasury could reintroduce the 3-year note without significant disruption to the market. This member acknowledged that generally Treasury has considered the 3-year note to be a fairly flexible security, and that the market would not view reintroduction of the security negatively if such a move was properly telegraphed. Several members agreed with this perspective.

At this point, Committee members reached consensus that discontinuing the 3-year note at this time was advisable.

The Committee then considered the question of what might be done if the fiscal situation improves further. Committee members noted that Treasury may need to consider additional adjustments to the calendar if the fiscal outlook improved more rapidly than expected. Several members suggested that Treasury continue to evaluate other options in the event they need to be acted upon, including eliminating the 5-year TIPS, the consolidation of the 10-year note auction cycle, and any other prudent measures.

One member pointed out that 5-year TIPS cash flows were not that unique and that real money investors where more interested in the cash flows generated by longer-dated TIPS. Another member noted that Treasury has shown commitment to the TIPS program, and given that inflation-indexed securities are a core element of the overall portfolio, TIPS need to be reviewed just as any other security. Another member suggested that Treasury should be flexible in considering all options.

Most members felt that Treasury should keep its options open regarding the future fiscal situation and the potential need to cut financing. Members suggested that Treasury wait and evaluate technical and market factors as well as consider modifications of issue sizes and or elimination of reopenings in certain nominal or real issues.

The Committee then addressed the second question in the charge regarding debt management within a framework of improving fiscal trends. Specifically, the Committee was asked to address what practices Treasury and market participants should consider in a significantly improving fiscal or surplus environment, given volatility in budget forecasts and the Administration's long-term plan to balance the budget. In addition, the Committee was asked to discuss what lessons can be learned from the 1998-2002 experience.

A presenting member led the discussion with a high level overview of the current debt management framework-- where the framework is working-- and where Treasury might consider improvements. The member cited three key areas in the overall framework 1) debt management 2) cash management, and 3) risk management. In the area of debt management, the member felt Treasury had adequate tools to manage the debt in all environments. The set of tools, which have been clearly elucidated to market participants, includes changing issue sizes, frequencies, and finally, the menu of offerings. Debt management has been proceeding very well on all fronts, according to the member, particularly with respect to transparency and issuance decisions. Transparency worked greatly to Treasury's advantage in reducing borrowing costs. The member noted that Treasury has used buybacks in the past and should be prepared to use this tool in the future should the fiscal outlook rapidly improve.

Regarding buybacks, the presenting member pointed out that Treasury had used one form of buybacks quite effectively in the past, and it may want to study another form of the buyback called "the switch" which is used by other countries. A switch involves issuing debt in one part of the yield curve to repurchase debt in another part of the curve. The member pointed out that previous buyback program had created significant cost savings for Treasury according to one study. The member also suggested the idea of continuous buybacks in small sizes to better balance the overall portfolio and maturity structure.

In the area of cash management, the member noted that the timing of receipts often presented problems for Treasury, and that the Treasury Tax and Loan program was suboptimal from both a capacity and return standpoint. The member suggested that Treasury consider using excess cash to buy short-term bills and coupons and also consider engaging in repurchase agreements. Both options may offer greater returns to the Treasury.

The presenting member then discussed Treasury's risk management, noting at the outset that other countries were further ahead in this area than the US. Specifically, the member suggested that Treasury consider using derivative transactions and swaps to change rollover risk. The member noted that such transactions would introduce credit risk into Treasury's portfolio, and that Treasury would need to decide if it wanted to accept such risk. The member noted that other counties such as Australia and Canada used these tools to continuing issuance despite having surpluses.

The presenting member than solicited comments and reaction from other Committee members. One member stated that the way the past buyback program operated, in which Treasury asked the market for offers on a basket of securities and selected only the best offers, was not good for real-money accounts because there was uncertainty about which issues would be repurchased.

Other members pointed out that the former buyback program, which focused generally on the long end of the market, was predicated on the idea that the US would be in surplus indefinitely and as such, long-term funding was no longer needed. Those members pointed out that fiscal outlooks change rapidly, and that such a motivation may have led to less than optimal repurchases.

A discussion arose whether Treasury should engage in continuous buybacks - continuous purchases of small lots in the market in the range of $50 to $100 million to retire debt - as opposed to the buybacks in the past, which were reverse auctions as large a $3 billion. Several members thought continuous buybacks were not advisable because it may not fall into Treasury's regular and predictable behavior framework. Another member suggested that using excess cash to opportunistically retire maturing debt – particularly when large maturities were coming due – was prudent. With regard to using swaps, several members member thought that using such a tool ran counter Treasury's objectives.

The Committee generally agreed that Treasury should continue to review its debt, cash, and risk management tools in light of the rapidly improving fiscal outlook in the event such instruments are necessary sooner rather than later.

Finally, the Committee was asked about trends related to international flows and capital investments, and if the Committee had any thoughts or suggestions with regard to these trends and the impact of the trends on Treasury's mission.

A Committee member presented a series of slides describing and characterizing international capital flows both into and out of the U.S. The member shared his thoughts on capital flows into various US capital markets including fixed income (Treasuries, agencies, corporate bonds), equities, direct investments (merger and acquisition related transactions), and private equity. The member noted the diverse set of inflows and the importance such inflows play in the U.S. economy.

The Committee member noted that foreign capital inflows provide a rising share of U.S. debt financing and allow stable U.S. investment, despite low savings, at lower interest rates. Estimates regarding how much lower rates are from these foreign capital inflows varied between 20 and 150 basis points, though such estimates are extremely difficult to verify. The member also stated that the U.S. net foreign investment position is still modest relative to GDP, but is forecasted to grow significantly in coming years.

The member noted that sources of foreign inflows are vulnerable to disruptions due to potential protectionist legislation, and that Congress should be wary of passing legislation related to international investment given their potential far reaching consequences.

Several members agreed that international investment was critical to ensuring strong, competitive capital markets in the United States. One member noted that opportunities abound globally, but that international investors still seek U.S. investments in one form or another given the depth of its markets.

Another member noted that the recent trend in establishing sovereign investment vehicles in Norway, China, Korea and other nations was a natural trend and that large flows of capital would still seek the most liquid, developed capital markets in the long run. One member suggested that Treasury offer products tailored to central banks given the amount of liquidity which they are seeking.

Director Ramanathan noted that Treasury seeks to have the broadest base of investors through its security offerings, and that tailoring specific products for specific audiences was currently not being contemplated.

Several members noted that the market needed to be aware that international investments came from many avenues and through many vehicles, and that forming a conclusion based on reviewing just one sector of the market, be it equities or Treasuries, was not wise.

The meeting adjourned at 12:55 p.m.

The Committee reconvened at the Hay-Adams Hotel at 6:10 p.m. All Committee members were present except for Richard A. Axilrod and Gary Cohn. The Chairman presented the Committee report to Assistant Secretary Ryan. A brief discussion followed the Chairman's presentation but did not raise significant questions regarding the report's content.

The meeting adjourned at 6:20 p.m.

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Office of Debt Management
May 1, 2007

Certified by:

Tom Maheras, Chairman
Treasury Borrowing Advisory Committee
Of The Securities Industry and Financial Markets Association
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